Kentucky Fried Chicken Corporation

Annual Report 1968

Directors

Jack C. Massey
Board Chairman

John Y. Brown, Jr.
President

Charles G. Hitner
Treasurer

Maurine F. McGuire
Secretary

J. Clarence Evans
Farris, Evans & Evans
Nashville, Tennessee

Ervin E. Hanks
President, Speck Enterprises, Inc.
Portland, Oregon

Leon W. Harman
President, Quality Distributors
Los Altos, California

Philip Clauss
President
Wayne Hobby Ranch House Restaurants
Fort Wayne, Indiana

Harland Adams
President
Kentucky Fried Chicken, Inc. of Florida
Miami, Florida

John Mihalic, Jr.
Group Vice President
AVCO—Nashville, Tennessee

William T. Young
Board Chairman
Royal Crown Cola Co.
Columbus, Georgia

Officers

Jack C. Massey
Board Chairman

John Y. Brown, Jr.
President

Donald D. Greer
Vice President & Executive Asst. to President

Kent E. Prestwich
Executive Vice President

Donald V. Maxfield
Financial Vice President

Kenneth J. Coomer
Vice President & President of
Kentucky Fried Chicken
International, Inc.

George W. Baker
Vice President & President of
KFC Operating Co.

George Gray
Vice President of Purchasing & Distribution

Charles G. Hitner
Treasurer

Maurine F. McGuire
Secretary

J. Clarence Evans
General Counsel

Administrative Staff

William L. Sheets
President, Commenco Corporation

Carroll V. Willoughby
Director of Administration

A. Carroll Jones
Marketing and Advertising Director

Arthur E. Pelster
Director of Engineering

John R. Neal
Director of Franchising

Al Nicholson
Director of Field Services

Lou Karibo
Director of Training School

Dewey A. Danner
Controller

Margaret Allard
Credit Manager

Joe Jetton
Equipment Sales Manager

Transfer Agents

First National City Bank
New York, New York

The Third National Bank in Nashville
Nashville, Tennessee

Registrars

Bankers Trust Company
New York, New York

First American National Bank
Nashville, Tennessee

Counsel

Farris, Evans & Evans
Nashville, Tennessee

Simpson, Thacher & Bartlett
New York, New York

Auditors

Ernst & Ernst
Nashville, Tennessee

About the Cover

This photograph of Colonel Harland Sanders holding a globe full of Kentucky Fried Chicken symbolizes the company's expanding operations in international markets.

Kentucky Fried Chicken Corporation

Annual Report 1968

for the year ended September 30, 1968

Operating Highlights

Year ended September 30

	1968	1967*
Gross income:		
Retail outlets	**$50,804,879**	$26,455,391
Equipment and supplies	**25,265,925**	15,751,143
Fees	**5,729,207**	3,529,431
Other	**4,430,493**	3,895,819
	$86,230,504	$49,631,784
Income before taxes	**14,988,124**	7,968,640
Provision for income taxes	**7,853,828**	3,916,029
Net income	**7,134,296**	4,052,611
Per share earnings*	**.78**	.47
Weighted average number of common shares outstanding	**9,189,788**	8,654,031
Cash flow:		
Net income	**7,134,296**	4,052,611
Depreciation and amortization	**1,620,748**	844,046
	8,755,044	4,896,657
Per share	**.95**	.57

**Restated to reflect poolings of interest.*

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To Our Shareowners:

John Y. Brown, Jr.
President and
Chief Executive Officer

Jack C. Massey
Board Chairman

By all standards, fiscal 1968 was the most successful year in the history of the Kentucky Fried Chicken Corporation. Our growth this year was consistent with each of the two previous years of our existence as a publicly-owned company.

This year marks a new milestone in our progress. The Board of Governors of the New York Stock Exchange is reviewing your company's application for the listing of our Common Stock on the Exchange. Granted approval, our stock should be traded on the New York Stock Exchange in early 1969, thus enabling Kentucky Fried Chicken to take its place among America's outstanding companies.

The most obvious indicators of the momentous strides made by our company during the fiscal year, which ended September 30th, are our consolidated net sales and net income. Our sales and operating income were up $36,598,720 over restated fiscal 1967 or a gain of 74 per cent. Net income increased by $3,081,685 for a gain of 76 per cent over restated 1967. Earnings per share of $.78, showed a gain of 66 per cent over the $.47 restated for the previous fiscal year. These earnings are reported after giving effect to the surtaxes which reduced earnings per share by approximately $.06.

Every indication points toward an outstanding year for fiscal 1969.

During fiscal 1968, we enhanced our leadership position in the franchising and food service industry. With more than 2,000 outlets bearing Colonel Harland Sanders' image, ours is the largest franchise operation in the fast foods field, with combined company and franchise sales in excess of $400 million. We feel our greatest period of growth and expansion lies ahead. Our immediate domestic goal is to double our number of stores, expanding at a minimum rate of 400 new stores annually.

Another profitable avenue of future corporate growth appears to be to the opening of new stores in the foreign markets. Stores already are in operation in Australia, Germany, the Philippines, Mexico, Jamaica, and the Bahamas, as well as in Puerto Rico, and are being built or planned for Japan, South America and the major European cities. Our market evaluations indicate that future sales and profits generated abroad should reach extremely significant levels. During the next fiscal year we will be making our initial entry, as well as laying a franchising foundation, in most of the countries where the business climate is favorable.

Kentucky Fried Chicken, with its "finger lickin' good" flavor and easy informality of fast food service, should find favorable acceptance in substantially all countries throughout the world.

This year was an extremely profitable one in terms of our major business, selling chicken. While we are still basically a franchise company, and plan to continue to expand our franchise opportunities, we have developed a strong retail operating

organization to manage an expanding program of company-owned units. Substantially all of our retail management has come from the franchisee ranks. This is the result of our acquiring, in the last two years, outstanding franchised operations along with their management.

The profit center of the company-owned operations was greatly enhanced this year through conversion of franchised outlets to company-owned stores under acquisition arrangements of mutual benefit. At our year end, we owned and operated 285 outlets compared with 10 just two years ago. The concept of managing large groups of stores has now proven successful and we plan to expand the number of company-owned outlets.

Another potential profit center is our Colonel Sanders' Kentucky Roast Beef program, which represents a broadening of our franchising image. While this is a comparatively new program to us, every available indicator tells us that with the most experienced management and franchise network in the fast food industry, Kentucky Roast Beef will be a popular and profitable franchise addition to our present line.

Another important management decision taken during the year was the one which embarked us upon our Combo Store program. These stores differ from our conventional outlets in that they sell a combination of Kentucky Fried Chicken and Kentucky Roast Beef. We are now able to locate combination stores in cities which are not large enough to support conventional outlets. In effect, this opens up an entirely new and potentially profitable market. At this time, our franchisees are successfully operating over 17 combination stores in towns and cities of 10,000 to 20,000 people. We see a sizable market for these stores, and believe that in time, they will contribute significantly to sales and profits.

This year was characterized by a dynamic company-wide expansion which made it necessary for us to make a long-range decision as to where to locate our new headquarters, the need of which became evident following a projection of future space requirements.

A number of factors were instrumental in our decision to move our facilities from Nashville, Tennessee, to Louisville, Kentucky. Among them was the very significant reduction in annual corporate state income taxes. Furthermore, your Board of Directors foresaw great promotional and sales value in relocating our company to a state with which it is so closely identified. We expect to complete this move late in 1969.

Our record accomplishments of the past are now history, and so we turn our attention and energy to the great opportunities which lie directly ahead. We are proud of the fine management team that has been assembled at Kentucky Fried Chicken Corporation. This team, which we believe is the finest in the franchising industry, will enable us to broaden our base as a franchising and food service organization. Our entire management team is dedicated to making Kentucky Fried Chicken Corporation one of the great companies of America. We are a young company, with great opportunities ahead, and the continued support of our shareowners, employees and customers, will help us reach our goals.

John Y. Brown Jr.

John Y. Brown, Jr.
President and
Chief Executive Officer

Jack C. Massey

Jack C. Massey
Board Chairman

Management in Depth

Jack C. Massey, Left, Board Chairman of Kentucky Fried Chicken, discusses plans for new headquarters with **John Y. Brown, Jr.** President and Chief Executive Officer

One of the year's most significant developments, and one which will rapidly accelerate your company toward the great opportunities of the future, was a strengthening and realignment of its senior operating management.

A company such as ours finds its greatest strength in the capabilities, experience, energy and loyalty of its employees. The managerial, administrative and service team we have assembled at Kentucky Fried Chicken Corporation is now fully qualified and prepared to soundly develop the opportunities of the future.

John Y. Brown, Jr., President of your company since 1964, was elected Chief Executive Officer. In the past five years, Mr. Brown has submerged himself in the daily operations of the company and has shown a sure and steady hand in helping to guide it through the formative years into a position today as one of the country's largest and fastest growing franchising and food service organizations.

The explosive growth of your company since it was purchased from Colonel Sanders by Mr. Brown and Mr. Massey, has placed ever increasing demands on its senior management. This required a finer division of administrative and managerial responsibilities in order to provide the talents necessary to plan for the continued growth of your company.

A number of other officers of the corporation were assigned broader and more clearly defined responsibilities.

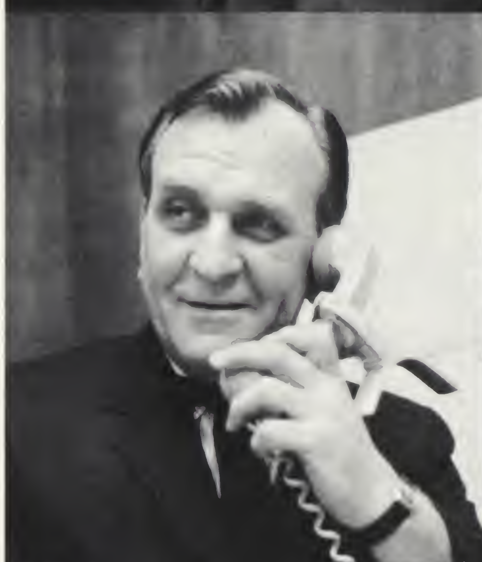
Kent E. Prestwich was elected Executive Vice President. Kenneth J. Coomer, a corporate vice president, was named to the additional position of President of our subsidiary, Kentucky Fried Chicken International, Inc. Donald V. Maxfield was elected Vice President in charge of finance. George W. Baker, President of our subsidiary, KFC Operating Co., was elected a corporate Vice President. George Gray was elected Vice President of Purchasing and Dewey A. Danner was named Controller.

Kent E. Prestwich
Executive Vice President

George W. Baker
Vice President

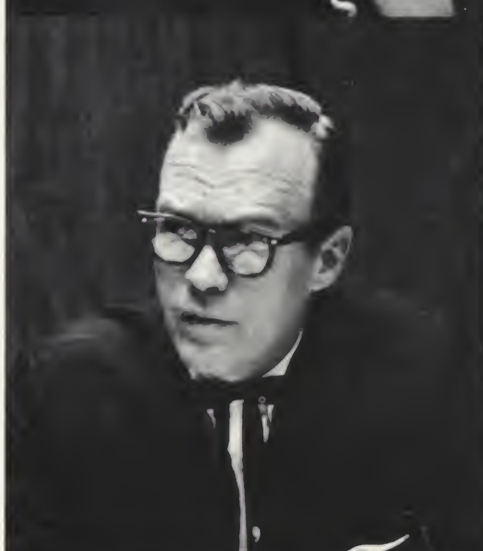
Kenneth J. Coomer
Vice President

Donald Greer
Vice President



Donald V. Maxfield
Vice President

George Gray
Vice President



The World's Number One Chicken Salesman

The white suit, the gleaming cane, the silvery hair, goatee and mustache, the beaming face, the casual wave of the hand, the cheery words: they all add up to Colonel Harland Sanders, the image of the Kentucky Fried Chicken Corporation.

Colonel Sanders is one of the most easily identifiable men in the world—a man who bespeaks Kentucky Fried Chicken each time he crosses a hotel lobby, or appears on national television, or participates at the dedication of a new Kentucky Fried Chicken store.

Today, Colonel Harland Sanders is widely known and recognized. But this was not always so.

The Colonel's origin was humble and obscure, as indeed were those of your young but growing company. Yet the Colonel completely overcame his inauspicious beginnings and went on to amass considerable fame and fortune. In the process, he created a success story that remains unparalleled in the annals of modern industry.

The image and story of Colonel Sanders is real, and one of the few authentic legends in the food industry. The Colonel is a food expert, a member of the Hall of Fame of the National Restaurant Association, and a member of its Board of Directors for the past 32 years. The Colonel was the first to invent the method of frying chicken under pressure, using a secret recipe of 11 herbs and spices, along with a special method of preparation. Colonel Sanders has received numerous national and international awards in the restaurant field and received the Horatio Alger Award in 1965 for his rags-to-riches story.

But like so many other men who come late in life to their major achievement, Colonel Sanders was not to become the motivating spirit of Kentucky Fried Chicken until many years had passed.

As a restaurant operator in Corbin, Kentucky, fried chicken quickly became the most popular item on his menu. The chicken was so good that the restaurant became widely known, and prospered as a local landmark for more than thirty years. The restaurant thrived until a new highway routed traffic completely away from the Colonel's restaurant. Without a steady stream of customers, business dwindled, and the restaurant finally collapsed.

So, at the age of 65, when most men begin to contemplate the pleasures of a well-earned and financially secure retirement, the Colonel was faced with financial ruin.

But the Colonel's credo is both simple and direct. "Work," he believes, "is the basis of living. A man will rust out quicker than he will wear out. I will never retire."

Armed only with a social security check for $105, Colonel Harland Sanders loaded his chicken cooker, his ingredients, his idea, and his indomitable will-to-succeed into a creaky old car, and set off across the nation.

His aim was to recruit restaurant operators as franchisees for Kentucky Fried Chicken.

The rest is now history, and is clearly chronicled in the financial ledgers of the company. They show how an idea has grown from infancy into one of America's largest fast foods companies, represented today by more than 2,000 outlets across America in every one of the 50 states. But mainly, it stands as testimony, undiminished by the passing of the years, to the vision, courage and conviction of one man who refused to bow before adversity, who refused to accept defeat, and who rejected the notion that the elderly cannot find a new and better world in their later years—Colonel Harland Sanders.

Colonel Harland Sanders, during a visit to a Kentucky Fried Chicken store, chats with two pleased customers.

Colonel Harland Sanders, The World's No. 1 Chicken Salesman

Advertising and Promotion

It is not by chance alone that Kentucky Fried Chicken is accepted as the finest chicken product available, or that its public spokesman, Colonel Harland Sanders, is among the most easily recognizable men in America. This recognition and acceptance was gained largely through an intensive program of advertising, promotion and brand identification.

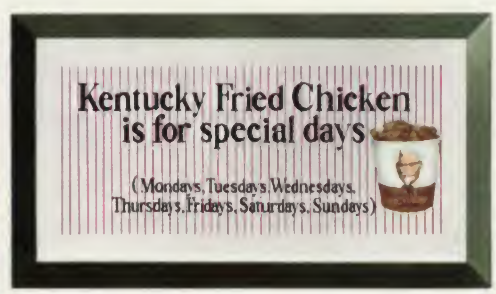
Kentucky Fried Chicken Corporation is extremely conscious of its image. How well it conveys and merchandises that image, in large part, determines the success of its business. Our business in the past has been excellent, and will, we believe, continue to be excellent in the foreseeable future. We attribute this, in large part, to the efforts that have been exerted in so successfully carrying our message into millions of homes.

This has been accomplished through a national cooperative advertising program between the company and its franchisees that is rapidly becoming a model which other franchising companies are adopting.

In fiscal year 1968, the company and its franchisees spent approximately $18 million in national and local advertising. These funds purchased newspaper and magazine ads, radio spots, television commercials, outdoor advertising posters, point-of-sale material and direct mail advertising. During this past year, our franchisees voted to raise their contributions to the national cooperative advertising program to 1% of their gross sales, which will result in an increased advertising budget for 1969.

Our banner is carried by Colonel Harland Sanders. The Colonel, the greatest living image in the food industry, constitutes one of our greatest assets. Through a lifetime contract as a good-will ambassador, Colonel Sanders has devoted his full and untiring efforts toward helping to build a bigger and better Kentucky Fried Chicken.

He has appeared as a guest celebrity on 26 national television shows, telling millions of viewers of the quality of our product. The Colonel's distinctive face will continue to smile out at Americans from national television programs, from the pages of national magazines and from billboards and store-front displays.



Top: This ad, showing Colonel Sanders in a picnic setting, appeared in several national magazines.

Bottom, left: This scene, taken from a television commercial, underscores the demand for Kentucky Fried Chicken.

Bottom, right: This message has appeared on billboards across America.

This Kentucky Fried Chicken Store, through an image-conformity program, is the same as nearly all other outlets in the company's nationwide network.

Domestic Expansion

In terms of our domestic activities, the year was a highly significant and innovative one, and easily ranks as one of the most important in our history. Fiscal 1968 took on added importance, for even as we were solidifying existing programs, new concepts were being put into operation.

Because we are constantly searching for new and more effective ways to sell our major products, the franchised and company-owned store programs were improved and brought to new peaks of efficiency.

During the past fiscal year, we initiated a national program to up-grade our outlets to meet our national image of the red and white cupola roof and, in addition, to relocate old secondary sites to prime locations. Our franchisees have aggressively committed themselves to this undertaking and have taken significant steps to implement the program.

During this past fiscal year, we opened in excess of 350 new outlets, both franchised and company-owned stores. This pace will be accelerated during fiscal 1969, with plans calling for an additional 114 company-owned outlets. The company will continue to acquire, under favorable conditions, areas containing four or more outlets with sufficient potential whereby they can be managed and controlled effectively. The attractiveness of these acquisitions has been in increased income and increased potential, and in increased management strength as well.

Two other programs involving operation of stores are new. The first of these is the Combo Store, the other is the Kentucky Roast Beef program.

The significance of the combination store, which serves both Kentucky Fried Chicken and Kentucky Roast Beef, is that it now permits us to serve small communities which could not support conventional stores.

The other program, involving our Colonel Sanders' Kentucky Roast Beef stores, is viewed as a promising new profit center. The same meticulous care and quality that goes into the preparation of Kentucky Fried Chicken has gone into the development of Kentucky Roast Beef. We recognize that the roast beef field is more competitive than the fried chicken field, but remain fully confident that our franchise system, the most experienced in the fast food field, will win speedy and widespread acceptance of our Roast Beef program.

We have three pilot stores under construction as a part of the planning of our Interstate Program. We are developing this program in conjunction with major oil companies and as our pilot units prove successful, we will rapidly proceed with the construction of Kentucky Fried Chicken stores adjacent to gasoline stations along the interstate highway network.

The anticipated success of these and other programs made it imperative that we devise new and more profitable ways of cooking chicken and still maintain our quality standard. We took a giant stride toward this goal by investing three years of unrelenting work in the development of a new automated chicken cooker. Our new cooker, which was successfully tested in certain of our company-owned stores, dramatically increases the number of servings that can be cooked each day and at a sharply reduced cost in labor, while insuring a more uniform and higher quality product than before. The new cooker will be made available on a lease plan to our franchisees with installation taking place during the next three years.

We are well abreast of the fast food industry and are analyzing other types of food packages that might be successfully operated and franchised. The creating, testing and evaluation of new ideas never ends at the Kentucky Fried Chicken Corporation. For out of these efforts can emerge a new chicken cooker, a combination store, a Kentucky Roast Beef—some new program, in short, that can translate itself into new income, in turn building a bigger, better and more profitable Kentucky Fried Chicken Corporation.

New Colonel Sanders Kentucky Roast Beef
stores are being opened throughout the country.

International Expansion

A plan which the Kentucky Fried Chicken Corporation has contemplated almost since the first days of its existence became a reality during fiscal 1968—our evolution from a regional company into a national company and, now, into an international company.

Early last year, we took our first step in this new direction of worldwide involvement. We plan to intensify this program and will aggressively be franchising outlets throughout Europe, Australia, South Africa, Asia and South America. We have established a company-owned expansion program in parts of Europe and Australia. While all of our foreign potential looks most promising, it is difficult to estimate with accuracy its contribution over the next few years, except to point out that we will be proceeding as rapidly as our management capabilities, our financial resources and government regulations will permit.

Fiscal 1968 was the year in which we completed the planning and conceptualizing for this international expansion. The opening of stores should begin on a large scale during the coming years and will continue until optimum penetration is accomplished.

The reputation we have achieved in the United States is one of serving excellent food in a minimum period of time and at a very reasonable price. We anticipate that these same qualities will assure us of an equally large measure of success abroad.

Another factor which will assist Kentucky Fried Chicken in winning new friends all over the world is the fact that chicken is universally the second most popular meat product. In countries where beef is not economically available, or where by local custom is not consumed in large quantities, chicken is the most popular food product. Moreover, the cost factor of chicken is reasonably stable throughout the world, thereby, allowing product cost to closely correspond to our domestic cost structure.

At this time, we have stores in Australia, Germany, the Philippines, Mexico, Jamaica and the Bahamas, and have current plans to open new units in the major European markets and parts of South America. In Japan, we have a joint venture agreement with one of Japan's largest corporations.

To administer this far-reaching and ambitious program, we have assembled a team of experienced personnel, who have previously proven their abilities in our domestic franchising and food service expansion programs.

These skills are largely interchangeable between domestic and international operations because the requirements of successful franchising are essentially the same throughout the world. Our top management, many of whom were formerly franchisees of the company, has successfully demonstrated its ability to direct a successful franchise system.

This team is headed by Kenneth J. Coomer, a corporate vice president, who was recently elected president of our subsidiary, Kentucky Fried Chicken International, Inc. As part of his new duties, Mr. Coomer recently completed an extended tour of the major European cities in which he negotiated agreements with prospective franchisees, local lenders and real estate groups.

Assisting Mr. Coomer is Don Vaninni, who is in charge of European company-owned store developments, and was formerly a vice president of company-owned stores in the United States. Adolf Jochnick, who has practiced law in New York City for the past seven years and is fluent in four European languages, has been named head of the European legal staff.

This, then, is the dimension and direction of our foreign expansion program. It represents a new path which we have chosen to take. But in many ways, the path is a familiar one, for it is lined with people whose appetites for good food are the same. We are optimistic that, in time, Kentucky Fried Chicken will become as widely known and preferred abroad as it is in the United States.

Colonel Sanders and Kentucky Fried Chicken are widely known in Germany.

Kentucky Fried Chicken is extremely popular in the Philippines.

This Kentucky Fried Chicken store in Australia was among the first to be constructed under the international expansion program.

Field Services and Training

Franchising is a two-way street. It always has been, and always will be. What is unusual is that so few companies realize this, and even fewer bother to put this theory into practice.

What makes the Kentucky Fried Chicken Corporation unique among franchising and food service concerns is its early and continuing acceptance of this principle.

We have learned that in helping our franchisees make money, we help ourselves make money.

We treat our franchisee as our business partner. This concept has proven highly successful; our more than 500 franchisees, including both individual and multiple operators, are each operating profitably. Our relationship with our franchisees has been such that there has not been a single lawsuit.

We take our first step in insuring this compatible and profitable cross-relationship by making a detailed evaluation of each application we receive for a franchise.

We are not interested in obtaining the services of absentee managers, who would leave the responsibilities of running their stores to others. We are interested only in men and women who will devote their energy to making a personal success of the ownership and operation of a Kentucky Fried Chicken franchise. For in working for themselves, such men and women are working for us, as well.

Having awarded a man a franchise, and assuring him of exclusive distribution in a specific area, we feel we owe this person the basic tools he needs to make a success of his venture.

The new franchisee is enrolled in a week-long course at our Kentucky Fried Chicken University. Instruction is given in the preparation and cooking of chicken or beef, operation of equipment, maintenance and sanitation. When this instruction is coupled with lectures on accounting, sales, advertising, customer service, catering and purchasing, the franchisee emerges from Kentucky Fried Chicken University as a skilled and proficient manager.

Although graduation from Kentucky Fried Chicken University is a major step in the development of a new franchise, it is really the beginning, rather than the end, of the company-franchisee relationship.

The services of every specialist employed or retained by the corporation, and there are many such people, are available to the franchisee, whether his need be finance, sales, promotion, engineering or purchasing.

The primary responsibility of the franchisee to the company is to maintain our high standards of performance, in terms of the quality of product, the appearance of stores and the level of customer service.

We have a series of programs designed to link one franchisee to another. We do this because, after making allowances for local conditions, the challenges confronting any one store are largely the same as those confronting any other store. We want, therefore, to make the experiences, abilities and perceptions of each franchisee available to all franchisees.

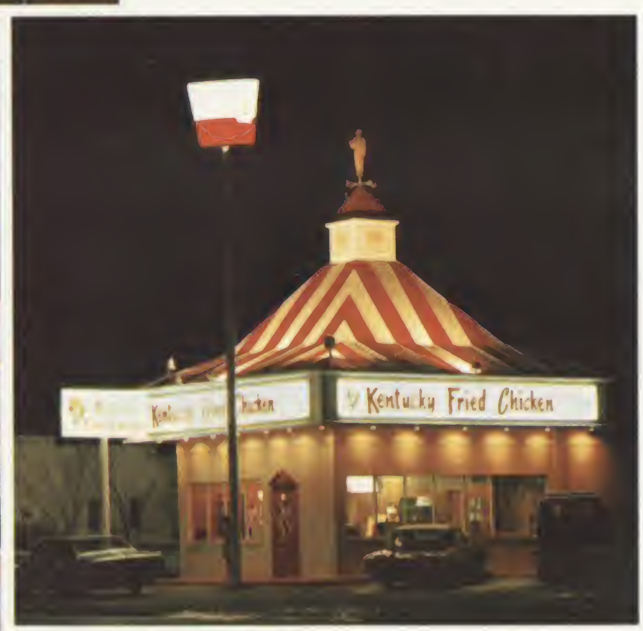
One step in this program is the publication of our internal magazine "The Bucket." This publication, which is sent to all franchisees, contains a wealth of information devoted to helping all people associated with the Kentucky Fried Chicken Corporation to do a better job.

Each year, we hold regional seminars for several days, bringing our franchisees together for meetings and lectures on every aspect of our business. Additionally, each year we have a national convention, bringing together representatives of our franchisees, suppliers and company personnel, to promote better understanding, solve mutual problems, and strengthen relationships.

All of us continue to strive to do a better job. Our franchise system was successfully built on the theory of working together. The theory of a franchise is doing together what cannot be done alone.

Kentucky Fried Chicken store personnel prepare for a busy day.

Counter areas in Kentucky Fried Chicken stores are always spotless—service is always given with a smile.



Kentucky Fried Chicken stores are as easily recognizable at night as during the day.


WALL ST.
NEW YORK STOCK EXCHANGE

Statement of Consolidated Operations

Kentucky Fried Chicken Corporation

and Consolidated Subsidiaries

	Year ended Sept. 30, 1968	Year ended September 30, 1967 — Restated for Poolings of Interest	Year ended September 30, 1967 — As Previously Reported
Net sales	$80,196,536	$45,868,270	$30,611,570
Cost of goods sold	45,143,466	27,043,885	18,992,540
	$35,053,070	$18,824,385	$11,619,030
Monthly franchise fees	5,227,767	3,235,431	3,491,755
Initial franchise fees	501,440	294,000	294,000
Other operating income	304,761	234,083	234,083
	$41,087,038	$22,587,899	$15,638,868
Selling, general, and administrative expenses	26,043,526	14,470,343	8,463,895
	$15,043,512	$ 8,117,556	$ 7,174,973
Other income	323,818	181,301	160,216
	$15,367,330	$ 8,298,857	$ 7,335,189
Other deductions	379,206	330,217	234,807
INCOME BEFORE INCOME TAXES	$14,988,124	$ 7,968,640	$ 7,100,382
Income taxes:			
Federal (includes income tax surcharge in 1968 of approximately $520,000—$.06 a share)	$ 7,202,417	$ 3,577,521	$ 3,251,570
State	651,411	338,508	324,177
	$ 7,853,828	$ 3,916,029	$ 3,575,747
NET INCOME	$ 7,134,296	$ 4,052,611	$ 3,524,635
Net income per Common Share (after providing $.06 a share in 1968 for income tax surcharge)—Note 2	$ .78	$ .47	$ .41

Note 1—The sales and income of the constituent corporations for the year ended September 30, 1968, were as follows:

	Sales and Other Operating Revenue	Income	Income Per Share
Kentucky Fried Chicken Corporation	$69,276,246	$ 6,559,674	$ .72
The subsequently acquired companies	16,954,258	574,622	.06

Note 2—The net income per Common Share gives effect to the potential conversion of 25,000 shares of Series A Preferred and 4,000 shares of Series B Preferred Stock into 425,526 shares of Common Stock, and is based upon the weighted average number of shares outstanding during the year.

Depreciation and amortization included above amounted to $1,620,748 for 1968 and $844,046 for 1967.

See notes to consolidated financial statements.

Consolidated Balance Sheet

Kentucky Fried Chicken Corporation
and Consolidated Subsidiaries

	Sept. 30, 1968	September 30, 1967 Restated for Poolings of Interest	September 30, 1967 As Previously Reported
ASSETS			
Current Assets			
Cash	$ 8,102,014	$ 3,173,286	$ 2,417,691
Trade notes ($1,253,024 at September 30, 1968, and $558,369 and $622,131 at September 30, 1967) and accounts receivable, less allowance for doubtful accounts of $301,431 at September 30, 1968, and $176,020 at September 30, 1967	7,328,737	4,374,894	4,144,382
Merchandise inventory—at lower of cost (first-in, first-out method) or market	1,853,345	975,889	712,142
Marketable securities	1,204,259	109,229	100,729
Prepayments and other current assets	583,419	514,347	410,921
Accounts receivable from shareowners	-0-	178,668	178,668
TOTAL CURRENT ASSETS	$19,071,774	$ 9,326,313	$ 7,964,533
Other Assets			
Equipment notes and contracts receivable for equipment rental (most of which have title retained as collateral), reduced by unearned income thereon of $803,197 at September 30, 1968, and $582,570 and $455.045 at September 30, 1967, less amounts due within one year of $1,250,276 at September 30, 1968, and $727,255 and $791,017 at September 30, 1967, included with current assets	$ 1,179,674	$ 870,773	$ 934,536
Cash surrender value of life insurance	141,277	96,848	80,864
Sundry other assets	443,783	215,039	73,137
	$ 1,764,734	$ 1,182,660	$ 1,088,537
Property and Equipment—on the basis of cost—Note B	18,346,272	7,754,818	5,878,106
Intangible Assets			
Franchises—at cost, less amortization of $852,322 at September 30, 1968, and $666,332 at September 30, 1967	$ 671,721	$ 857,711	$ 857,711
Other intangible assets, less amortization	612,778	293,573	119,445
Cost in excess of net assets of consolidated subsidiaries at date of acquisition— Notes A and B	4,849,593	2,356,119	2,356,119
	$ 6,134,092	$ 3,507,403	$ 3,333,275
	$45,316,872	$21,771,194	$18,264,451

See notes to consolidated financial statements.

	Sept. 30, 1968	September 30, 1967 Restated for Poolings of Interest	September 30, 1967 As Previously Reported
LIABILITIES, CAPITAL STOCK, AND SURPLUS			
Current Liabilities			
Notes payable—bank	$ 250,154	$ 381,233	$ 285,188
Trade accounts payable	4,938,014	2,736,407	2,095,677
Deposits on franchise contracts	1,046,200	309,577	309,577
Accrued taxes and interest	987,026	299,320	229,226
Accrued compensation and related items	681,445	464,595	265,052
Federal and state income taxes—Note H	3,965,909	2,982,084	2,685,513
Dividends payable	110,699	78,687	65,801
Portion of long-term liabilities due within one year	1,815,093	836,427	560,460
TOTAL CURRENT LIABILITIES	$13,794,540	$ 8,088,330	$ 6,496,494
Long-Term Liabilities—Note C	2,823,020	4,255,586	3,568,235
Capital Stock and Surplus			
Preferred Stock—Note F			
Series A—2% cumulative and convertible, par value $100: Authorized, issued, and outstanding 25,000 shares	$2,500,000	$ 2,500,000	$ 2,500,000
Series B—2% cumulative and convertible, par value $100: Authorized, issued, and outstanding 4,000 shares	400,000	400,000	400,000
Undesignated as to series, par value $100: Authorized 100,000 shares; issued—none			
Common Stock, no par value (giving effect to all stock splits and shares issued in poolings)—Notes F and G Authorized 10,000,000 shares; 9,224,672 issued September 30, 1968, and 8,599,992 and 8,104,584 issued September 30, 1967 (including shares in treasury)	2,767,402	2,579,999	1,256,637
Capital surplus	12,663,383	158,082	1,107,498
Earned surplus	10,758,155	4,178,825	3,342,384
	$29,088,940	$ 9,816,906	$ 8,606,519
Less cost of Common Stock in treasury (199,700 shares at September 30, 1968, 199,700 and 208,500 at September 30, 1967)	389,628	389,628	406,797
	$28,699,312	$ 9,427,278	$ 8,199,722
COMMITMENTS AND CONTINGENT LIABILITIES—Note D			
	$45,316,872	$21,771,194	$18,264,451

See notes to consolidated financial statements.

Statement of Consolidated Surplus

Kentucky Fried Chicken Corporation

and Consolidated Subsidiaries

		Year ended September 30, 1967	
	Year ended Sept. 30, 1968	Reinstated for Poolings of Interest and Stock Split	As Previously Reported
Capital Surplus			
Balance at beginning of year	$ 158,082	$ 194,470	$ 194,470
Excess of option price of stock sold to employees and franchisees over stated value	487,192	584,210	584,210
Proceeds in excess of stated value of fractional shares sold in connection with 5-for-4 stock split	-0-	17,968	17,968
Excess of market value over average cost of treasury stock issued in acquisition of consolidated subsidiary	-0-	305,336	305,336
Excess of capital of pooled companies acquired over stated value of Common Stock issued in poolings of interest and related adjustments	158,436	461,088	140,590
Other credits to capital surplus	14,573	-0-	-0-
Proceeds in excess of stated value of 200,000 shares of Common Stock sold	11,940,000	-0-	-0-
	$12,758,283	$ 1,563,072	$ 1,242,574
Deduct amount transferred to Common Stock in connection with stock splits:			
3-for-1—December 15, 1967	$ 1,903	$ 135,076	$ 135,076
2-for-1—November 1, 1968	92,997	1,269,914	-0-
	$ 94,900	$ 1,404,990	$ 135,076
BALANCE AT END OF YEAR	$12,663,383	$ 158,082	$ 1,107,498
Earned Surplus			
Balance at beginning of year	$ 4,178,825	$ 3,047,723	$ 3,047,723
Adjustment to conform fiscal periods of companies pooled during 1967	-0-	94,312	94,312
Earned surplus of companies pooled during 1968 at beginning of year	-0-	482,687	-0-
	$ 4,178,825	$ 3,624,722	$ 3,142,035
Net income for the year	7,134,296	4,052,611	3,524,635
	$11,313,121	$ 7,677,333	$ 6,666,670
Deduct:			
Cash dividends on:			
Preferred Stock—$2.00 a share	$ 58,000		
Common Stock—$.05 a share (1967—$.03⅓ a share)	$ 428,786	$ 259,178	$ 259,178
Cash paid in lieu of fractional shares in connection with 5-for-4 stock split	-0-	17,984	17,984
Excess of par value of Preferred Stock issued over par or stated value of Common Stock of companies acquired in 1967 in poolings of interest	-0-	2,880,000	2,880,000
Dividends and other adjustments of pooled companies prior to merger	68,180	341,346	167,124
	$ 554,966	$ 3,498,508	$ 3,324,286
BALANCE AT END OF YEAR	$10,758,155	$ 4,178,825	$ 3,342,384

See notes to consolidated financial statements.

Statement of Consolidated Source and Application of Funds

Kentucky Fried Chicken Corporation

and Consolidated Subsidiaries

Year ended September 30, 1968

Source of Funds

Net income	$ 7,134,296
Depreciation and amortization	1,620,748
FROM OPERATIONS	$ 8,755,044
Proceeds from sale of 400,000 shares of Common Stock	12,000,000
Proceeds from sale of 219,984 shares of Common Stock upon exercise of options	520,190
	$21,275,234

Application of Funds

Property and equipment—net	$11,923,893
Net decrease in long-term debt	2,815,889
Cash dividends	510,017
Cost of subsidiaries purchased in excess of their net assets, less long-term debt incurred	1,108,004
Franchises, trademarks, and other intangible assets	421,517
Other	456,663
	$17,235,983
Increase in working capital	$ 4,039,251
Working capital at beginning of year	1,237,983
WORKING CAPITAL AT END OF YEAR	$ 5,277,234

See notes to consolidated financial statements.

Notes to Consolidated Financial Statements

Kentucky Fried Chicken Corporation

and Consolidated Subsidiaries

September 30, 1968

Note A—Principles of Consolidation and Acquisitions

The accompanying consolidated financial statements include the accounts of the Corporation and its foreign and domestic subsidiaries, all of which are wholly-owned. All material intercompany accounts and transactions have been eliminated. The accounts of the foreign subsidiaries have been converted at current or other appropriate exchange rates.

During the year ended September 30, 1968, the Corporation acquired seven corporations (in addition to those which were included in the 1967 annual report) for 57,192 shares of its Common Stock. From October 1, 1968, to December 3, 1968, the Corporation acquired thirty-eight corporations (the subsequently acquired companies) for 169,920 shares of its Common Stock. These transactions have been accounted for as poolings of interest, and the 1967 consolidated financial statements have been restated to give effect to the accounts and transactions of the pooled companies.

During July, 1968, the Corporation purchased for cash and notes all of the outstanding capital stock of sixteen corporations. The Corporation's investment in these subsidiaries exceeded their net assets at date of acquisition by $2,493,474. See Note B. The consolidated financial statements include the accounts and transactions of these purchased subsidiaries from the dates of their acquisition.

Note B—Property and Equipment

Details of the Corporation's property and equipment are as follows:

		September 30, 1967	
	September 30, 1968	Restated for Poolings of Interest	As Previously Reported
Buildings and improvements	$ 3,491,568	$1,039,370	$ 862,787
Transportation equipment	1,217,101	335,984	144,736
Office and furniture and equipment	251,039	207,463	162,176
Other equipment	8,902,294	4,531,623	3,275,308
Leasehold improvements, including retail outlets	3,467,836	1,936,536	1,211,296
	$17,329,838	$8,050,976	$5,656,303
Less allowances for depreciation and amortization	3,257,239	1,532,093	926,192
	$14,072,599	$6,518,883	$4,730,111
Land	3,407,749	1,022,234	934,294
Construction in progress (estimated cost to complete at September 30, 1968, $2,900,000)	865,924	213,701	213,701
Total Property and Equipment	$18,346,272	$7,754,818	$5,878,106

Provision for depreciation of property and equipment has been made on a basis considered adequate to amortize the cost of depreciable assets over their estimated useful lives, generally by the declining-balance method as to equipment acquired prior to October 1, 1967, and generally by the straight-line method for other property and equipment. The annual amounts of such allowances were computed on the basis of the following range of lives.

Buildings	8 to 40 years
Transportation equipment	3 to 8 years
Furniture and equipment	3 to 10 years
Other equipment	3 to 10 years
Leasehold improvements	3½ to 20 years

Repairs, maintenance, and renewals are charged to income. Expenditures for improvements have been capitalized. The policy of the Corporation is to relieve property accounts and related allowances for properties retired or otherwise disposed of, at

Note B (continued)

amounts included therein for such properties, and any gain or loss resulting therefrom has been included in the statement of income.

The cost of franchises is being amortized over a period of from 97 to 120 months from date of acquisition.

Trademarks and organization expense are being amortized over a period of five years from the date such costs are incurred.

The amount by which the Corporation's investment in Commenco Corporation (formerly Commercial Investment Company) exceeded the net assets of that company at date of acquisition is being amortized over three years from the date of acquisition.

The Corporation's investment in subsidiaries acquired since September 30, 1966, exceeded the aggregate of their net assets at date of acquisition by $4,849,593. This amount is not being amortized.

Note C—Long-Term Liabilities

The details of long-term liabilities are as follows:

		September 30, 1967	
	September 30, 1968	Restated for Poolings of Interest	As Previously Reported
5½% note payable to bank, due December 3, 1968	–0–	$2,500,000	$2,500,000
3% note issued to Col. Harland Sanders, due in annual installments of $300,000 in 1968 and 1969, and $200,000 in 1970 (retired October 15, 1968)	500,000	800,000	800,000
5½% mortgage note payable in monthly installments of $1,206, including interest	146,371	152,607	152,607
Mortgage notes payable in various installments including interest from 6% to 7% per annum	273,441	65,674	65,674
Other installment notes due on various dates	3,518,301	1,273,732	310,414
5% note payable to Jack C. Massey, due in annual $100,000 installments	200,000	300,000	300,000
	$4,638,113	$5,092,013	$4,128,695
Less amount due within one year included with current liabilities	1,815,093	836,427	560,460
Total Long-Term Liabilities	$2,823,020	$4,255,586	$3,568,235

The mortgage notes payable are collateralized by deeds of trust on properties costing $838,287 and $772,050 at September 30, 1968, and September 30, 1967, respectively.

Following is a summary of the aggregate maturities of the long-term liabilities:

Year ending:

September 30, 1969	$1,815,093
September 30, 1970	1,300,835
September 30, 1971	942,888
September 30, 1972	132,026
September 30, 1973	94,608
Maturing beyond five years	352,663

Note D—Commitments and Contingent Liabilities

At September 30, 1968, the Corporation and its subsidiaries were lessees under 283 leases, having terms expiring from 1968 to

Note D (continued)

1988. The leases call for minimum annual rentals exclusive of real estate taxes, maintenance and insurance payments required by some of the leases, as follows:

1969-1973	$2,237,285
1974-1978	2,010,524
1979-1983	1,520,190
1984-1988	368,607

The Corporation plans to move its executive offices from Nashville, Tennessee, to Louisville, Kentucky, during 1969. In connection therewith, the Corporation acquired land at a cost of approximately $480,000 of which $334,500 had been incurred at September 30, 1968.

Note E—Profit-Sharing Plan

The Corporation has a contributory profit-sharing plan, adopted by the predecessor corporation and continued by the Corporation, which provides retirement benefits for eligible employees who elect to participate. The Corporation's contribution may not exceed 10% of compensation (excluding bonuses) of participating employees. The amount charged against income was $51,188 and 37,515 for the year ended September 30, 1968, and September 30, 1967, respectively.

One subsidiary has entered into an agreement to pay retirement benefits to certain key employees upon the attainment of age 65. These benefits are funded by insurance policies covering the lives of the various participants. At September 30, 1968, policies were in effect on the lives of the participants with a gross annual premium of $7,840.

Another subsidiary has a pension plan which provides retirement benefits for certain eligible employees of the subsidiary, generally at age 65. The Corporation's policy is to fund pension cost accrued under the individual level cost (premium) method. However, the Corporation intends to discontinue this pension plan. Inasmuch as the assets of the fund exceed the vested benefits of the participants, no provision was made for pension costs under this plan during 1968.

Note F—Capitalization and Stock Options

Changes in authorized capital structure and stock splits:

On December 29, 1966, the Corporation effected a 5-for-4 stock split and reduced the stated carrying amount per share from $1.00 to $.80.

(Note F continued above)

Note F (continued)

On December 15, 1967, the Corporation changed its capital structure to authorize 25,000 shares of Series A 2% cumulative convertible Preferred Stock, 4,000 shares of Series B 2% cumulative convertible Preferred Stock, 100,000 shares of Preferred Stock undesignated as to series, and 10,000,000 shares of Common Stock. Thereupon, it effected a 3-for-1 Common Stock split and changed the stated carrying amount per Common Share from $.80 to $.30. In connection with the stock split $135,076 was transferred from capital surplus to capital stock.

On November 1, 1968, the Corporation effected a 2-for-1 stock split and in connection therewith $92,997 was transferred from capital surplus to capital stock.

Franchisee Stock Options:

The Corporation granted options to franchisees to purchase 735,672 shares of the Corporation's Common Stock at $1.84 a share (after giving effect to all stock splits). The options are not transferrable, may be exercised at any time after June 24, 1966, and expire March 31, 1969. The option price is equal to the net price at which a public offering was made at the time the options were granted.

Options have been exercised as follows:

	Number of Shares (a)	Approximate Market Value at Date Exercised	Option Amounts Paid at Date Exercised
Year ended September 30, 1966	113,556	$ 464,581	$208,946
Year ended September 30, 1967	341,028	2,257,373	639,079
Year ended September 30, 1968	188,184	5,215,515	348,327

(a) After giving effect to all stock splits.

Employee Qualified Stock Option Plans:

On December 6, 1966, the Corporation adopted a qualified stock option plan for certain key administrative and executive personnel. The plan reserves a maximum of 150,000 shares (after giving effect to all stock splits) of authorized Common Stock for issuance, subject to the plan's restrictions, to selected participants. This plan terminates January 9, 1969.

TABLE FOR NOTE F	Year ended Sept. 30, 1968	Year ended Sept. 30, 1967	Range of Option Prices at Date of Grant	Aggregate Option Prices	Aggregate Market Value at Date Exercised
Outstanding at beginning of period	68,100	–0–			
Granted during the year ended September 30, 1967		68,100	$ 5.00-$14.29	$ 571,600	
Granted during the year ended September 30, 1968 (b)	43,400		15.00-$40.25	1,110,922	
Exercised	(31,800)			170,000	$578,725
Outstanding at end of period	79,700	68,100			

Note (b) Includes option for 9,000 shares reinstated pursuant to court order.

On October 10, 1968, the Corporation adopted (subject to shareowners' approval at the next annual meeting) the 1968 Qualified Stock Option Plan. The plan reserves a maximum of 150,000 shares (after giving effect to the 2-for-1 stock split) of the Corporation's authorized Common Stock for issuance, subject to the plan's restrictions, to selected participants.

To November 7, 1968, additional options had been granted for periods not to exceed five years to employees to purchase 38,325 shares at the market price at the date granted.

Conversion Privileges of Preferred Stock:

On the first anniversary of the original issue, and on each of the succeeding such anniversary dates, 20% of the outstanding shares of the Series A Preferred and of the Series B Preferred will become convertible into Common Stock of the Corporation, so that at the end of the five-year period following such issue, all outstanding shares of both series will be fully convertible. The Series A Preferred will be convertible into full shares of Common Stock at the rate of 15 shares (after giving effect to all stock splits) of Common Stock for each share of Series A Preferred, and the Series B Preferred will be convertible into full shares of Common Stock at the rate of 12.63156 shares (after giving effect to all stock splits) of Common Stock for each share of Series B Preferred.

At any time beginning six years after the date of issuance of the Series A Preferred and Series B Preferred Stock, the Corporation will have the right, by 30 days' written notice, to redeem the whole or any part of either or both such series at par plus an amount equal to accrued and unpaid dividends.

Note F (continued)

Other Matters:

The following shares of authorized but unissued Common Stock were reserved:

	Sept. 30, 1968	Sept. 30, 1967
For conversion of Preferred Stock:		
Series A	375,000	375,000
Series B	50,526	50,526
For outstanding options:		
Franchisee options	92,904	274,944
1966 Employee Qualified Stock Option Plan	118,200	150,000
1968 Employee Qualified Stock Option Plan	150,000	-0-

(Note F continued above)

Note F (continued)

All amounts referred to in the consolidated financial statements are stated in current shares, after giving effect to all stock splits.

46,059 shares of Common Stock outstanding are held in escrow to be released to former shareowners of the pooled companies, if and when specified conditions are met.

The Corporation has made application to the New York Stock Exchange for the listing of its Common Stock. It is anticipated that this application will be approved by the Board of Governors on December 19, 1968.

Note G—Changes in Common Stock

	Shares Year ended September 30			Amount Year ended September 30		
		1967			1967	
	1968	Restated for Poolings of Interest	As Previously Reported	1968	Restated for Poolings of Interest	As Previously Reported
Balance at beginning of year	8,599,992	1,293,926	1,293,926	$2,579,999	$1,035,141	$1,035,141
Common Stock sold during the year:						
Franchisee options exercised	94,092	170,514	170,514	26,437	45,470	45,470
Employee qualified stock options exercised	15,900			4,658		
Other	200,000			60,000		
Common Stock issued in connection with poolings of interest:						
During 1967		136,500	136,500		40,950	40,950
During 1968, to September 30		28,592			8,578	
From October 1, 1968, to December 3, 1968 (the subsequently acquired companies)	4,696	149,562		1,408	44,870	
Issued in connection with stock splits: 3-for-1—December 15, 1967		2,587,852	2,587,852	1,903	135,076	135,076
2-for-1—November 1, 1968	309,992	4,233,046		92,997	1,269,914	
Balance at End of Year	9,224,672	8,599,992	4,188,792	2,767,402	$2,579,999	$1,256,637

The Corporation delivered 8,800 shares of Common Stock held in the treasury which was carried at $17,169 in connection with an acquisition of a subsidiary during 1968.

Note H—Federal Income Taxes and Investment Credit

The federal income tax returns filed by the Corporation and subsidiaries through the year ended September 30, 1966, have been examined by the Internal Revenue Service, and provision for taxes assessed as a result of such examinations has been made.

Under the terms of merger or acquisition agreements, the Corporation has recourse against shareholders of the acquired corporations for undisclosed liabilities including income taxes, limited in some cases to the excess of a specified amount.

The investment credit was not a material amount. It is the policy of the Corporation to include the investment credit in income for the year in which it arises.

Note I—Subsequent Events

The Corporation has acquired two retail outlets from its franchisees at a cost of approximately $105,000.

The Corporation has agreed to acquire three retail outlets in California for 8,142 shares of its Common Stock, and one retail outlet in California for $140,500. The transactions are to be completed upon the receipt of audited financial statements of the companies involved, and subject to the authorization of the transactions by the California Division of Corporations.

Note I (continued)

On October 10, 1968, the Corporation declared a dividend of $.10 per share payable quarterly at $.02½ per share beginning January 15, 1969, to shareowners of record on December 31, 1968, and with subsequent quarterly payments to shareowners of record at the close of business on March 31, June 30, and September 30, 1969.

The Corporation has contracted with Mr. Louis Hutchison, a former key employee who was principally involved in the development of the concept of marketing roast beef, to sell eight (8) of its Kentucky Roast Beef units and to sublease nine (9) additional ground leases to him and to grant to him exclusive rights to expand the Kentucky Roast Beef operations in six (6) areas.

The Corporation's obligations on leases on the units being transferred amount to $233,000 per year generally for fifteen (15) years, with certain renewal options, of which $1,500,000 is guaranteed to the Corporation by Mr. Hutchison.

As partial consideration, Mr. Hutchison is to pay the Corporation one-half (½%) per cent of sales as additional rental on these units.

Accountant's Report

Board of Directors and Shareowners
Kentucky Fried Chicken Corporation
Nashville, Tennessee

We have examined the consolidated balance sheet of Kentucky Fried Chicken Corporation and consolidated subsidiaries as of September 30, 1968, and the related consolidated statements of operations and surplus and source and application of funds for the year then ended. Our examination was made in accordance with generally accepted auditing standards, and accordingly included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances. We previously made an examination of the consolidated financial statements for the preceding year.

In our opinion, the accompanying consolidated balance sheet and consolidated statements of operations and surplus and source and application of funds present fairly the consolidated financial position of Kentucky Fried Chicken Corporation and consolidated subsidiaries at September 30, 1968, and the consolidated results of their operations for the year then ended, in conformity with generally accepted accounting principles applied on a basis consistent with that of the preceding year.

Nashville, Tennessee
December 13, 1968

Ernst & Ernst

Kentucky Fried Chicken®
CORPORATION